TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES

Meeting minutes from Thursday, May 28, 2015
Finance Department Conference Room, 5th floor
City Hall, 255 West Alameda, Tucson, Arizona 85701

Members Present: Robert Fleming, Chairman
Curry Hale, HR Director
Silvia Amparano, Director of Finance
John O'Hare, Elected Retiree Representative

Staff Present: Dave Deibel, Deputy City Attorney
Allan Bentkowski, Treasury Finance Manager
Michael Hermanson, Plan Administrator
Dennis Woodrich, Lead Pension Analyst (departed 8:46 AM)
Dawn Davis, Administrative Assistant

Guests Present: Jenefer Carlin, CTRA Representative
Gordon Weightman, Callan Associates Inc.
Catherine Langford, Yoder & Langford, P.C. (participated electronically)
Teri Smith, Aberdeen Asset Management
Maree Mitchell, Aberdeen Asset Management
Robert Lopez, City of Tucson employee

Absent/Excused: Kevin Larson, City Manager Appointee
Michael Coffey, Elected Representative

Call to order- Chairman Fleming called the meeting to order at 8:41 AM.

A. **Consent Agenda**

1. Approval of April 30, 2015 TSRS Board Meeting Minutes
2. Retirement ratifications for May 2015
3. April 2015 TSRS expenses compared to budget

A motion to approve the Consent Agenda was made by Curry Hale, 2nd by Silvia Amparano, and passed by a vote of 3 – 0 (Kevin Larson and Michael Coffey absent, Chairman Fleming did not vote).

B. **Application For Medical Retirement** – Robert Lopez*

A motion to enter executive session was made by Curry Hale, 2nd by John O'Hare, and **passed by a vote of 3 – 0** (Kevin Larson and Michael Coffey absent, Chairman Fleming did not vote).

A motion to return to regular session was made by John O'Hare, 2nd by Curry Hale, and **passed by a vote of 3-0** (Kevin Larson and Michael Coffey absent, Chairman Fleming did not vote).

A motion to approve the disability retirement application of Robert Lopez was made by Curry Hale, 2nd by Silvia Amparano, and **passed by a vote of 3-0** (Kevin Larson and Michael Coffey absent, Chairman Fleming did not vote).

C. **Investment Activity Report**

1. Annual Investment Manager Review – Aberdeen Asset Management – Teri Smith, Senior Relationship Manager and Maree Mitchell, Senior Equity Specialist

Gordon Weightman explained the Board hired Aberdeen in 2012. They manage close to $42M for the Tucson Supplemental Retirement System (TSRS), investing in non-US stocks in developed and emerging markets. Their long term performance is very strong, but their performance record over the last 3 years has been weak on a relative basis vs. peers and the benchmark. For the quarter ending March 31, 2015, Aberdeen stands in the 98th percentile compared to peers, returning 1.12% vs. the MSCI ACWI xUS benchmark was up 3.49%, underperforming an index fund. Among the things they will speak to the Board about today are reasons for their underperformance.

Teri Smith told the Board that Aberdeen had acquired FLAG Capital Management, LLC. It is small, in terms of assets of around $6B, as Aberdeen manages around $500B. The acquisition is good for the firm in terms of the capability it adds to the private equity space in the US private equity market, and in Asia with their Hong Kong office. She gave an update on the assets within the portfolio. The EAFE Plus Fund, the product they manage for TSRS, falls into the Global Equities group with $43.1B assets under management. In the EAFE Plus strategy, there is $7.6B in assets under management. Over the last 2 years $1.8B flowed into the strategy and $3.4B flowed out, for a net outflow of $1.5B. The reason for the net outflow might be that Aberdeen does not actively market their global and EAFE products. Similar to their emerging market products they were not trying to rapidly grow their equity assets under management in the emerging markets and international or EAFE space. This is because they are trying to broaden their asset base and diversify what they do; they are trying to look at fixed income and some other alternatives as areas of growth for the firm.

Maree Mitchell explained the firm's investment philosophy and processes for the EAFE Plus strategy. The global equity team utilizes the research and analysis from 95 investment managers, based around the world. Between the 95 managers, there were 4,000 company visits performed last year. They are bottom up investors and do their own internal research and analysis. They believe their competitive advantage is the amount of research and analysis done, not only before they invest in a company but also once they invest in a company they meet with management at least twice a year to make sure they are up to date on events to avoid any surprises which could negatively affect the portfolio. In the last few years, a lot of share prices have moved on the back of macro news rather than corporate fundamentals. For example, because the Brazilian economy is struggling and there are political issues, many Brazilian stocks have been marked down. Aberdeen has invested in a Brazilian bank called the Bank of Verdasco; a good quality institution with good earnings, but their share price does not reflect that due to negative market sentiment towards Brazil. Aberdeen was able to take advantage of the situation by adding positions to that stock last year at a lower price. They cannot predict what will happen from a macro point of view but they can concentrate on the quality of the fundamentals. They have regional teams throughout the world, each of those teams are managing high conviction, well diversified portfolios with 40 to 60 stocks for their clients around the world. Combined, and excluding US stocks, there are about 280 international stocks which is the starting point of the investible universe for the global equity team to do additional analysis of those companies and determine the 40 to 60 stocks for the TSRS portfolio, which currently includes 44 companies. The global equity team meets with the regional teams biweekly to discuss the companies met, any recent results, and what has been done with the portfolios. The global equity team can purchase any stocks within the 280 stocks. The only time they have to follow the regional team is if the regional team sells a stock effectively removing it from the buy list.

Ms. Mitchell explained when they were analyzing the 280 stocks, done continually on a sector basis; they are making sure they are still comfortable with the stocks in the portfolio and there are no better options within the buy list. When they look to add a stock to a portfolio, they ask about additional diversification the stock can bring to the portfolio. Diversification by country is becoming less relevant due to globalization, but there are businesses in the UK that will have to grow globally in order to grow, so it was more important to understand where the company's revenue comes from rather than just seeing it as a UK stock. Because country weights are becoming less relevant to the MSCI index, they considered developing an index based on revenue by country at some point in the future.

Ms. Mitchell explained Aberdeen's sell discipline. They will sell stock if there is a deterioration of quality or valuation and went over the examples of QBE Insurance, PetroChina, Petrobras, and Centrica given on page 8 of the material provided to the Board.

Exited	QBE Insurance	Jun-14	Sold out of remaining small positions in QBE in view of better growth opportunities elsewhere.
	PetroChina	Nov-14	Sold out of PetroChina after strong relative performance. The share price held up relatively well due to the potential for reforms rather than anything fundamental.
	Petrobras	Dec-14	Sold out of Petrobras due to deterioration in the quality of the business.
	Centrica	Mar-15	Sold out due to increased regulatory and political interference around the stock.

Ms. Mitchell went over the performance summary for the last year.

Performance summary

Tucson Supplemental Retirement System

Performance summary	One year to end Dec 2014	Three months to end Mar 2015	One year to end Mar 2015	Annualized since inception (4/2/2012)
Fund (gross)	-2.53%	1.12%	-4.15%	4.65%
Fund (net)	-3.31%	0.92%	-4.92%	3.81%
Benchmark	-3.44%	3.59%	-0.57%	6.89%
Difference (gross)	0.91%	-2.47%	-3.58%	-2.24%

Market value of investment as at end March 2015: $41,935,592

At this time in 2014, they started well by outperforming the index by 300 basis points in Q1, but by year end, they lost some of the outperformance, due primarily to a sudden fall in commodities prices. As shown in the table, 2014 as a whole was okay but the first quarter of 2015 has been tough with underperformance in both asset allocation and stock selection. The overweight allocations to Brazil, the UK, Japan and Germany were negative factors. Brazilian stocks fell based on macro news and investor sentiment in the first quarter though they rallied significantly in April, showing how quickly the market can turn around.

Mr. Weightman asked if the disappointment felt at the firm over their underperformance over the last 3 years has caused any changes to the way they think about process and philosophy. In other words, based on the 3 year numbers, does anyone at the firm think anything is broken and needs to be fixed, or do they feel they should stay the current course?

Ms. Mitchell answered Aberdeen had good performance prior to TSRS investing with them 3 years ago. They have looked at their process, but believe in it for the long term and they believe in investing in quality companies with long term potential. From 2013 up to now, share prices have moved on the back of macro news rather than corporate fundamentals, creating a difficult environment for Aberdeen as bottom up stock pickers. Japan rallied this year, not because things have fundamentally changed, but because of quantitative easing in the hope that things will improve. Europe has rallied as well, but earnings have not been coming through because of their quantitative easing that has been occurred for 5 years now. She believed the worst thing for Aberdeen to do now would be to change their process.

Mr. Weightman asked if the process needed to be adjusted due to the change in environment.

Ms. Mitchell answered the fundamental process does not need to be adjusted but they did need to reassess the particular analysis driving their decisions to sell or hold a stock, providing an example of the underperformance of oil and Aberdeen's failure to recognize the changes in the energy cycles. They believe the market will return to being driven by fundamentals, but not until the US raises interest rates and while that is happening, with the uncertainty of when, there will be more volatility.

Mr. Weightman stated this had been evident in the US too because quantitative easing was a game changer. Suddenly investor's acceptable risk increases and they buy stocks when revenues do not necessarily support the asking price.

Ms. Mitchell answered that would have been the right choice if investing in the US over the last 4 years. The bubble will eventually break because values have become stretched, and a lot of those earnings improved on the back of buy-backs, rather than fundamentals. This is happening in Europe as well, as share prices are stretched and earnings are not coming through. They still believe the market will return to being driven by fundamentals resulting in Aberdeen's return to their previous performance. It has been said that Aberdeen has underperformed for close to 3 years and this must be because they are invested in poor quality companies. This would be a reasonable assumption if the stats were not there to back up these investments:

Aberdeen EAFE Plus Fund

Fund characteristics as at end March 2015

	Aberdeen EAFE Plus Fund	MSCI AC World ex US
P/E	16.11	17.15
Dividend Yield	3.16	2.80
Dividend Growth	12.66	11.07
P/B	2.01	1.77
ROA	7.20	5.76
ROE	17.57	15.33
Debt/Equity*	0.98	1.33

Ms. Mitchell said Aberdeen likes companies with solid business models and do not prefer companies with a lot of debt. Generally, their best ideas are about cash generative companies that have less debt than the market. Return on Assets and Return on Equity are both profitability measures and Aberdeen's characteristics are higher than the index, indicating their portfolio has companies with more profitability higher dividend yields by default. Those characteristics don't necessarily flow through to good stock performance values in the short term in an environment when share prices are driven by macro news instead of fundamentals.

Mr. Weightman explained there were 2 sides, one is performance and the other is the risk taken to try to attain that performance. What was explained by Ms. Mitchell results in a portfolio vs. peers that has a lower volatility.

Ms. Mitchel confirmed that they believed it was less risky. Aberdeen does not hedge currency at the individual stock level because currency does not have enough of a material effect to cover the cost of hedging over a long period of time. They expect to underperform in a momentum driven market or markets in which stock prices are changing based on macro news. They believe the quality aspects of these companies will hold up relatively well when the markets are falling, resulting in downside protection. There have only been 3 in the last 11 years when the markets have been down, 2014, 2011, and 2008. Aberdeen outperformed in 2008 and 2011; so they believe the portfolio is still positioned to protect their clients on the down side - if the bubble bursts in the US or in Europe and there is a sell off, their portfolio values will hold up. It is important for them to remind their clients about that protection on the down side.

Ms. Mitchell said 3 years is normally a good period of time to use for evaluating the firm's performance and we like to say we will outperform the index by at least 3% over a 3 year period. Clearly this has not been the case over the past 3 years and she understood how frustrating and difficult this was from a fiduciary point of view. As TSRS is coming up on 3 years since investing with Aberdeen, she hoped the Board would stick with them and give them a chance to prove that they are excellent long term investors.

Ms. Mitchell explained Aberdeen has direct and indirect exposure to emerging markets. Over the last few years emerging markets have underperformed developed markets because of quantitative easing, but also because the quality of earnings has not come through or has deteriorated in emerging markets. She thinks that they are positive on emerging markets for several reasons: First, they have seen an improvement in the earnings from emerging market companies, and as that comes through, the share price reflects it. In regards to the worry over what will happen in emerging markets when interest rates increase in the US, they believe it is already factored into the prices. When the Fed increases interest rates, it will likely be because there is sustainable growth and there will likely be companies importing from emerging markets in Asia, so an export driven recovery is likely. In the emerging markets portfolio, they have seen some companies with exposures to the US start to have increased revenues from exports which adds to their current deficits causing currency to strengthen and showing a cyclical downturn in emerging markets rather than the structural issues occurring in Europe.

Allan Bentkowski asked if their overall exposure in emerging markets was about 30%.

Ms. Mitchell answered yes.

John O'Hare asked if due to globalization they would expect it to impact the portfolio if there was a market crash in the US.

Ms. Mitchell answered if US stocks started to underperform because prices became too stretched and there are earnings disappointments, profits would be taken out of the US and placed elsewhere such as emerging markets, so then emerging markets would pick up and be a positive for the TSRS portfolio. If the US prices fell because the economy suddenly stopped and started to reverse, that would have a negative impact on the world.

Mr. O'Hare asked if the market would react defensively if the Fed raised interest rates.

Ms. Mitchell explained there would be a knee-jerk reaction in emerging markets, because the companies have US Dollar debt, and the stock prices of emerging market companies will be marked down on the first day. They believe the emerging markets are a lot less dependent on US Dollar debt than Chinese banks, so the prices of the Chinese banks will continue to fall, but the fall for companies in emerging markets will be short lived, and ultimately, the increased interest rates in the US will have a positive effect on the TSRS portfolio.

Mr. Weightman said the Fed is tasked with inflation and unemployment; they also have to be think about the growth and strength of the dollar because a lot of capital has come into the US with developed country bond yields so low. If the Fed starts to increase bond yields and there is an increase in longer dated treasuries that could bring even more capital to strengthen the Dollar further.

Mr. O'Hare asked about the fee the Board pays to Aberdeen.

Mr. Bentkowski answered in the last fiscal year, ending June 30, 2014, the Board paid Aberdeen $345K. The Board's other international manager charged $367K.

Mr. Weightman stated the other international manager did not have any emerging market exposure.

Mr. O'Hare asked what Aberdeen would like to be evaluated on over the index.

Ms. Mitchell answered their goal was to outperform the index by 3% per annum during a 3 year rolling period, although they did not achieve that in the most recent 3 year period.

2. March 31, 2015 TSRS Quarterly Review of Investment Performance – Callan Associates, Inc.

Gordon Weightman located the executive summary at the beginning of the performance measurement book. The executive summary shows the actual asset allocations of the plan vs. target. It shows Total Fund performance cumulative results and fiscal year results both gross and net of fees. The fiscal year results show 2011, 2013 and 2014 were good years, 2012 was not a very good year, and now the fund is at 3.5% through March 31, 2015. There will have to be some strong performance over the last 3 months of the fiscal year to reach the Board's expected rate of return. T. Rowe Price announced that their President/CEO is retiring, but they have a succession plan in place and it will not have any effect on the Board's portfolio. There is a portfolio manager leaving Causeway who covered the energy sector, which will affect the Board's portfolio. His securities selections represented about 7% of the Board's current investment, he is not the only manager covering the energy sector, there is a team, but he was the lead making his exit a substantial and notable change, however the international equity specialist at Callan is not concerned about the change given the deep bench at T. Rowe Price.

Active Manager Performance

Fund	Peer Group Ranking Last Year	Last 3 Years	Last 5 Years
PIMCO Stocks Plus	49	6	11
T. Rowe Price Large Cap Growth	59	14	[16]
Champlain Mid Cap	52	50	[46]
Pyramis Small Cap	29	19	20
Causeway International Value Equity	72	22	15
Aberdeen EAFE Plus	92	[98]	[69]
PIMCO Fixed Income	54	4	27
J.P. Morgan Strategic Property Fund	63	18	37
LaSalle Income and Growth Fund	96	94	98
JP Morgan Income and Growth Fund	44	8	1

** Brackets indicate actual performance linked with manager composite*

Mr. Weightman said the Active Manager Performance table shows peer group rankings of asset manager performance for the last 1, 3, and 5 year periods. Numbers in brackets indicates they are using the composite history because the TSRS portfolio measurement does not apply to the whole track record. For the most part, absent Aberdeen, the Board's managers are performing well. LaSalle has incoming growth; they sold their last property and are returning money to investors. The fund is supposed to be completely closed by the end of 2015 because a few legal issues must be worked out before the official closing. Champlain has bounced back a little; they are defensive managers like Aberdeen but in the US space. They like high quality companies that do not have a lot of debt. Over the last quarter they slightly outperformed their benchmark at 4.11%. Last year they trailed, but over the last 5 years in a roaring equity market, they have kept up; surprising because they tend to trail in up markets and make money in down markets. One of the easiest ways to think about performance is to look at the composites, US equity, non-US equity, fixed income, real estate; and infrastructure; this shows that domestic equity has been strong. In the last quarter, the domestic equity portfolio is up 2.6% ahead of the benchmark. That pattern persists over time, over 3 years the Portfolio has made money above the benchmark in domestic equity; and this is the same for 5 years. That can be broken down into large and midcap. Largecap, over 3 years, was higher than the benchmark at 17.32% vs. the S&P 500 index at 16.11% - which includes PIMCO StocksPLUS and T. Rowe Price. Mid cap over the last year returned 11.84%, which was really driven by Pyramis' healthcare and information technology holdings. Pyramis' performance over the last 3 years has been outstanding, and small/mid cap has been doing well in aggregate also. International equity as of late has been a weak spot. Over the last year, it was down 2.52%, with the index down 1.01%, primarily driven by Aberdeen. Fixed income is another healthy area; the Board's allocation is 1/3 to an index fund, and 2/3 to PIMCO, which has a custom mandate that it enters into emerging market debt and high yield and has performed very well. In aggregate, fixed income over 3 years is up 4.90% against the index, which was up 3.10%. Over the last year, real estate is up 12.5% in absolute returns vs. the NFI-ODCE Value Weight Growth index at 13.45%, and LaSalle has been the cause for underperformance. Infrastructure is a tough area, Macquarie is a very healthy fund; they own 2 airports that have appreciated and produced a lot of income for the Portfolio. The negative return is due to currency adjustments. Infrastructure is a diversifier for the TSRS portfolio providing income, but is a difficult target for benchmarking purposes because it is an absolute and it is positive. Over the long term, the Board expects to obtain that, and that has been the case over 5 years, but over shorter periods infrastructure is a bit of a wild card because it has a target that is always 4% plus inflation. After fees in the last quarter, over the last year, the portfolio returned 7.39%, behind the benchmark at 8.22%, this is close to the expected rate of return but behind the benchmark, with much of that difference driven by infrastructure, real estate, and Aberdeen. Over 3 years, the Board is 1.02% ahead of the benchmark, and over 5 years, the portfolio matched the benchmark at 10.34%; after 10 years the board trailed with 6.69% vs. the total Fund benchmark at 7.04%. These results are not only based on the active manager's skill, they are also dependent on whether the portfolio is overweight or underweight in certain areas compared to the benchmark.

John O'Hare stated; back in the beginning of the 3 and 5 year periods, the target was 7.75% so the Board dropped it by 0.5% to make the numbers look better.

Michael Hermanson commented, however, the Board's investment policy was unchanged when the target was 7.75%, and even currently, the manager allocations were the same, but future expectations have been reduced to 7.25%, not to look better, but to match future capital market performance expectations coupled with changes in the investment policy currently being considered.

Mr. O'Hare asked if the 3 and 5 year numbers based on the target of 7.75% or 7.25%.

Mr. Weightman answered the 3 year number was based upon the former asset allocation policy which was 7.75%. As a result of the asset liability study the Board adopted a target of 7.25%.

Mr. Hermanson clarified that the 3 and 5 year numbers reflect the index vs. performance.

Chairman Fleming explained the target of 7.75% or 7.25% is only related to the Board's funding level.

3. TSRS Portfolio composition, transactions and performance review for 04/30/15

Allan Bentkowski reported the 4/30/15 Total Fund balance was $746.3M; at 3/31/15, it was at $739.4M; and on 5/21/15 asset values hit another all-time high for the plan at $754.8M. As of 5/27/15, the value was $752.9M. During the month, $1.5M was taken out of Alliance to fund retiree pension payments, and the fund expects to receive $648K from LaSalle for property sold from this strategy during May.

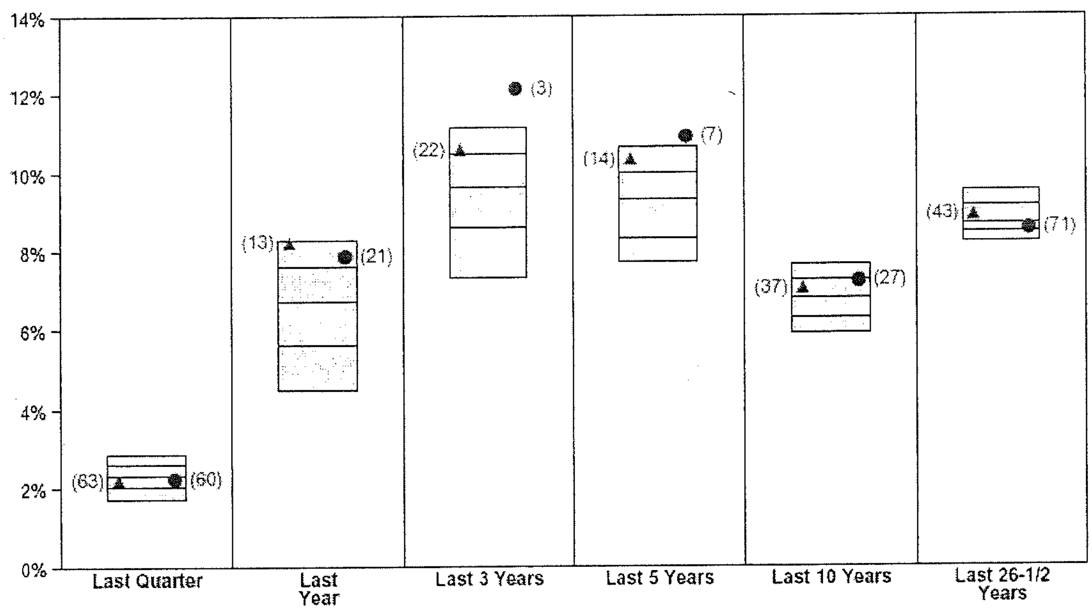
Calendar 2015 YTD – for the month of April, the Total Fund returned 1.14% vs. the Custom Plan Index return of 0.86%; Total Fixed returned 0.02% vs. the Barclays Aggregate return of -0.36%; Total Equities returned 1.39% vs. the Equity Composite return of 1.33%. Year to date returns through April for Total Real Estate were 5.1% vs. the NCREIF return at 3.39% (index through March 31 only). For April, Total Infrastructure returned 2.22% vs. the CPI +4% benchmark return of 0.53%.

Fiscal 2015 YTD – the Total Fund trails the expected rate of return, posting a return of 4.63% through April vs. the Custom Plan Index return of 5.14%. Thus far, May has been a strong month, but the Portfolio return will probably fall short of the expected 7.25% through 6/30/15, but it might be close. Total Fixed Income returns were 2.25% vs. the Barclays Aggregate return at 3.22%; Total Equities returned 5.91% vs. the Equity Composite return of 5.44%; dragged down by Aberdeen's -5.08% for FYTD; Total Real Estate added 9.25% through April vs. the NCREIF return of 10.22% as of March, and Total Infrastructure returned -5.52% vs. the CPI +4% return of 2.57%.

Mr. Bentkowski explained that the 1 YTD performance table had been added to the materials at the request of John O'Hare and it gives the Board a good perspective of where the Plan is on a yearly basis. The Plan is trailing the expected rate of return on a fiscal YTD basis, but the 1 YTD shows a Total Fund return at 8.42% vs. the Custom Plan Index return of 8.66%; Total Fixed returns were 4.46% vs. the Barclays Aggregate return of 4.45%; Total Equities returned 10.4% vs. the Equity Composite return of 10.10%; Real Estate returned 11.44% vs. the NCREIF return of 13.45%, and Total Infrastructure returned -0.93% vs. the CPI +4% return of 3.80%. The Total Infrastructure return was largely affected by Macquarie and currency exchange rates. Finally, Allan told the Board they have received around $1.5M during the last fiscal year from Infrastructure, through April, and LaSalle produced a $1.9M cash flow from their liquidation.

Mr. Weightman provided some information to give perspective on the performance. He directed the Board to turn to page 42 of the Callan book provided prior to the meeting. The chart shows peer rankings for TSRS vs. about 150 other public plans across the US.

Performance vs Public Fund Sponsor Database (Gross)



	Last Quarter	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 26-1/2 Years
10th Percentile	2.87	8.28	11.16	10.66	7.65	9.53
25th Percentile	2.61	7.62	10.50	9.97	7.26	9.13
Median	2.32	6.73	9.62	9.31	6.80	8.69
75th Percentile	2.05	5.62	8.60	8.31	6.30	8.47
90th Percentile	1.72	4.50	7.34	7.71	5.92	8.23
Total Fund ●	2.23	7.86	12.14	10.91	7.23	8.54
Total Fund Benchmark ▲	2.21	8.22	10.58	10.34	7.04	8.90

Over the last year TSRS is in the 21st percentile and the top quartile. Over the last 3 years TSRS was in the 3rd percentile, over 5 years it was in the 7th percentile, and over the last 10 years it was in the 27th percentile. This is a reflection of the asset allocation which contains more equity than some, and TSRS has been one of the top performers.

4. Board Discussion of Draft Revised TSRS Investment Policy Statement (for adoption 6/25/2015)

This item was taken out of order and considered after item C1.

Gordon Weightman said with the completion of the asset liability study and the associated changes in asset allocation, the Board's investment policy statement needed to be updated to reflect those changes. Callan looked at it and worked with staff to updated a lot of the language in the policy for the Board. There are some sections that carried over from the current policy, affecting the performance criteria and guidelines for investment managers; other than that, there is a lot of new language. At Callan they work with a lot of public funds to help them with their investment policy statements, and this draft is what they think is best in class from their experience with those other public funds. Page 1 starts with background purpose and objective of the TSRS Board, then it states investments will be made for the sole interest of members and beneficiaries in accordance with the following objectives, tasks the Board already does and acknowledges so it is not new. The objectives have been simplified:

1. To attain a rate of return net of investment management fees equal to or exceeding the expected rate of return. TSRS will be managed in perpetuity indicating a long time horizon in which to evaluate investments.
2. To manage the assets of TSRS in a cost effective manner.

The duties of the Board are listed on page 3, and include roles and responsibilities of the Board, staff, and service providers. What it comes down to, on page 7, is an overarching paragraph with a lot of language from the prudent man theory.

Chairman Fleming asked if board, staff, and service provider were defined anywhere in the proposed updates to the investment policy statement.

Mr. Weightman answered that they could add those definitions. One objectives for today's discussion was to obtain feedback from the Board because it was the Board's policy and the updated version presented is a working draft of the policy. The draft was developed from working with Allan Bentkowski, Michael Hermanson, and Silvia Navarro. Page 9 shows asset allocation guidelines have been updated to reflect the new target allocations per asset class.

Michael Hermanson advised this investment policy has not been adopted yet; the idea was to review the draft over the next month and adopt it at the June 25, 2015 meeting.

Allan Bentkowski advised that he was the contact person for comments, so the Board should contact him with any changes, and he would review with staff and confer with Callan.

Mr. Weightman stated the message was the same as the current policy, it is just written differently to be more concise and straightforward. There is one area that has changed significantly, the Watch List Procedure and Criteria. The updated watch list procedure would be kept broader than in the past; in the past there were specific criteria for 1 and 3 years based on relative returns and peer group rankings. The draft still includes the quantitative and qualitative factors listed in the policy statement, but ultimately when it comes to watch list determination it is based on judgment and confidence. Aberdeen is a perfect example because they have been behind the benchmark for 3 years by 300 basis points and the Board is paying them $350K a year, are they worth it or did the Board think they could find another manager that could perform better? The Board is in a position where they are going to give their international equity managers a lot more money, is that something they want to give to Aberdeen? He did not want to make it specific to that one manager, but that is a part of the evaluation process. There is nothing wrong with their shop, they are operating the way they have since 1998, but their recent performance has been poor.

Chairman Fleming stated, perhaps the policy statement should say that once Aberdeen is placed on the watch list there will be an agenda item that will allow the Board to vote on whether to replace them every month. He believed one of the organizational problems is the Board can hear Aberdeen's presentation after waiting to hear from them for several months, and maybe they should replace Aberdeen but cannot because it is not on the agenda today.

Mr. Weightman answered that was up to the Board and that typically what the watch list says is further evaluation is needed. Typically the minutes reflect that the Board recognizes the firm's shortcoming and will give them another year and reevaluate them when they give their next annual review, barring any qualitative events occurring.

Mr. Bentkowski explained that placing a firm on the watch list doesn't necessarily lead to termination of the manager; it just means closer tabs are kept on a firm when they are placed on the watch list.

Chairman Fleming liked the idea that the Board has an institutional watch list where something will happen and an actual entry on the agenda to take action regarding any company that is on the watch list.

Mr. Hermanson asked if the Board wanted to specify any length of time over which companies on the watch list would be scrutinized.

Mr. Weightman suggested stating that the Board would formally evaluate them again in a year.

Chairman Fleming stated that one of the questions the Board would ask if there was an action item on the agenda regarding Aberdeen was how much it would cost to go through the interview process again.

Mr. Weightman answered the searches are included in the Board's contract with Callan, so there would be no additional cost for a search. The only cost would be with the transition event that may result.

Mr. O'Hare asked about the transition costs.

Mr. Weightman answered it was below 50 basis points. It depends upon the space, in this case international equity which tends to be more expensive to transact. That was one of the things Callan was doing with the transition managers right now, so that the Board could have the different contracted transition managers give a pre-trade analysis for a point estimate and a standard deviation.

Mr. Hermanson said previous policy was that a manager would go on the watch list for a period of time with an unknown duration as opposed to the postulation of an assigned period of time for reevaluation.

Chairman Fleming envisioned that if the predetermined threshold is reached to place a management company on the watch list they would remain on the list until the Board decides the manager's performance has turned around enough that they do not need to be so attentive and every month there would be a short discussion about whether to keep them on the watch list, start the process of replacing them, or remove them from the watch list.

Mr. Weightman explained Callan could provide the Board with a firm's performance data in any format or grouping the Board would like. His opinion on Aberdeen was that they were at the bottom of their cycle; they are a very high quality manager. There were many stocks that went up in price and they have no earnings or revenue to support those prices. He gave the example of Southwest Airlines, whose price was up 100% last year because they did not raise their fares when oil prices dropped. All the airlines had tremendous run up in price but none of the active managers held them because when viewing their balance sheets there was a lot of debt and pension plans that were larger than the earnings and revenue of the company. These were the kinds of stocks Aberdeen avoids and there will be a period of time when a stock runs up and is not supported by anything, it will eventually fall. The Board just decided to increase the risk profile of the non-US equity portfolio by adding international small cap; Aberdeen invests in large companies of high quality with low debt, Causeway is lower in capitalization and has more value emphasis in their portfolio, and Callan thinks that combining those different qualities offer good portfolio attributes.

Mr. Hermanson asked if the Board wanted to identify the basic issues in the policy statement.

Mr. Weightman answered they were identified on page 19, Manager Evaluation and Review covers qualitative and quantitative criteria, and the watch list says based upon the manager evaluation section the Board should use it's judgment and confidence in the manager.

Mr. Hermanson asked who would track the criteria.

Chairman Fleming answered it should be added to staff's list of duties and the Board should implement a watch list procedure.

Mr. Weightman said that under Duties of the Board it said monitoring and evaluating each investment manager's success in achieving the objectives set for such manager by the board and adhering to the established guidelines. The guidelines are listed under Performance Objectives on page 12 where there is a benchmark and a peer group.

Chairman Fleming asked Mr. Weightman to add that the Board has an obligation to create and monitor a watch list for any manager who does not meet the guidelines, for Callan to let the Board know when they think it is appropriate, and staff needs to inform the Board when they think a manager needs to be included on the watch list.

Mr. Weightman said given the hypothetical situation where there is a lot of turnover in the Board's membership and some of the members who were involved in the hiring of investment managers and monitoring and evaluation of those managers were no longer on the Board, if there is quantitative criteria that says a company should be on the watch list the new members may feel obligated to act on it immediately when the best move may be to go through a more detailed due diligence process to learn about the managers and what their role is in the portfolio before acting on it. He worried that if there were specific criteria in the policy statement that said 3 years a new member might be comfortable firing them because it is in the policy even when obtaining more information may be the better option. The revision is meant to encourage the board to have an opinion on the matter rather than just stick to a concrete policy.

Mr. Bentkowski reminded the Board to send any changes to him by June 12, 2015.

5. Board Briefing of Transition Manager Interviews Scheduled for June 3, 2015

Allan Bentkowski explained that Callan and staff will be interviewing transition managers on June 3, 2015. The 4 finalists are State Street, Penserra, Macquarie, and Black Rock. Of those 4, they would like to select the top 3 to keep on retainer so they can bid against each other to perform transitions to new manager allocations.

Gordon Weightman said Black Rock and State Street work in all asset classes, whereas Macquarie and Penserra are more specific to certain areas.

D. **Administrative Discussions**

1. Board Consideration of Candidates Information for Vacated Board Position

Michael Hermanson explained, with the resignation of Eric Kay, the Board needed to fill the position vacated. According to the minutes from the April 30, 2015 TSRS Board meeting, David Deibel indicated the Board could appoint someone such as the candidate receiving the 2nd highest vote count in the last board member election, Jorge Riveros in this case. Candidate information presented on the 2014 ballot was included in the packet of materials provided to the Board for this meeting. All candidates were deemed to be qualified by the election committee and Jorge Riveros was contacted, indicating he was interested in serving on the Board.

Chairman Fleming asked if the Board could take action on this item today if they chose to do so.

Mr. Hermanson answered yes it was an action item.

John O'Hare asked when Eric Kay's term expired.

Mr. Hermanson answered it was a three year term that started in January of 2014 so the appointee would serve for approximately 18 months to the end of that term in January 2017.

Curry Hale stated that one of the candidates took personal time off from work to attend the Board retreat held on October 31, 2014, to see what membership would entail. Mr. Hale thought this showed initiative and he liked that the economics, financial, and accounting background of Jorge Hernandez, who he believed to be the attendee, would make him an excellent Board member.

Mr. Hermanson advised the Board that Jorge Hernandez had not yet been contacted to determine his level of interest due to the fact that was not the suggestion from last month's meeting, but he could contact him to confirm that he remained interested.

Chairman Fleming asked if both candidates could attend next month's meeting to give us a 5 minute pitch, and provide an opportunity to interview them, so that a well informed decision could be made.

Mr. Hale expressed support for this idea.

2. Progress Report on Reconfiguration of Quarterly Retiree Report

Michael Hermanson said the vendor is working on the assignment to add the YTD pay amount to the Quarterly Statement for retirees. The vendor was advised that the work should be finished in time for the new template to be used for the Quarterly Statement to be sent out in June 2015.

3. Securities Litigation Oversight Agreement - Robbins Geller Rudman & Dowd

Catherine Langford explained it is becoming more prevalent for law firms to be engaged by a plan to monitor their securities portfolio and make sure they are joining any securities class action litigation that is occurring if it involves securities the plan has invested in. In some cases the plans will become lead plaintiffs or initiate a law suit if there is a problem with a particular investment, she did not think this was a likely scenario for TSRS because it is so much smaller than the plans that are doing it. These law firms monitor the active investment and ongoing litigation to see if there is an opportunity for the plan to join an ongoing litigation matter or share in a recovery from one of these securities class action suits. It is a fairly passive process for TSRS. The law firms have developed specialized software that constantly generates and reviews litigation and investment reports. They obtain the information for these reports from the custodian so they do not have to get the data from TSRS. Then they send the report to the Board about their particular investments and any current and future securities actions. There will be a recommendation, if there is securities litigation occurring, from the law firm about whether to join and take an active or passive role. That is part of the free service these law firms are offering to provide. If the Board wants to move forward and join a litigation matter that is a separate engagement and at that point the Board is free to use the firm performing the monitoring or contract with another law firm to handle the litigation for them. In most cases if the plan has a very small stake in the litigation they would utilize the firm performing the monitoring services which is when the firm makes money. The monitoring firm is hoping to establish a relationship so that if TSRS elects to participate in any active litigation they will utilize the paid services of that law firm. In terms of fiduciary practice and best practice it makes sense to have someone looking at these things for them. The only caution she advised was that the Board wants to make sure the reports generated and delivered to TSRS are manageable and user friendly. She did not think it was prudent to bring on this firm if they produce a report that is not practical and that no one can invest the time to review.

Michael Hermanson described the sample report sent by the law firm for the Board. It is a short one page sample that lists the name of the case, the financial interest, the class period, and the date the motion is due. There are also write ups on the individual companies summarizing the case.

Allan Bentkowski explained the firm had initially proposed that they would work with the custodian to make sure that the custodian did not miss any potential class action lawsuits TSRS should passively participate in.

Mr. Hermanson answered this was correct, the idea was the law firm would be looking over the shoulder of BNY Melon to make sure nothing was missed.

Gordon Weightman asked if that would require the Board to take action and make a decision on whether they wanted to enter into a class action law suit every time one occurs.

Mr. Bentkowski answered that TSRS passively participates in all the class action law suits so the decision for the Board would actually be whether to participate actively or passively.

Chairman Fleming asked what the benefits of active participation would be.

Ms. Langford answered that she could not foresee a situation in which TSRS would be an active litigant. The only time the plans take an active role is when their stake is so significant that they would sue individually to recover damages whether there is a class action or not, TSRS is too small to have enough of a percentage of any potential loss or damage.

Chairman Fleming asked if TSRS hired a law firm to advise when they should actively participate is that when they would receive a percentage of the damages recovered. He also asked if in class action suits they located the stockholders and sent a check if they are in the class.

Ms. Langford answered typically yes they were required to locate the damaged investors and that is how the custodian is picking up the class actions on behalf of TSRS. By virtue of being a prior or current investor TSRS would ultimately share in the damages. The custodian registers TSRS as a potential claimant; the law firm is not necessarily going to wait for the class action law suit to come to TSRS, they will actively seek out these litigations, so there is a good chance that they will pick up things that the custodian may not and if the Board continues to participate on a passive basis she thought it would still be a free monitoring type service. She thought the law firm will get legal fees and share in a class action judgment if TSRS becomes and active or named party in the litigation, but she thought this was very unlikely for TSRS.

John O'Hare stated that his understanding was the law firm was offering to do a free audit to make sure the custodian has not missed any potential class action litigations for TSRS to participate in in the past, and that the next step would be to sign up for a monitoring service.

Chairman Fleming asked if there would be any negative consequences from asking the firm to perform a free audit.

Ms. Langford answered there would not be any negative consequences and that it was a good way to double check the custodian's work. She had not understood that the first step was to have an audit performed; she thought it was to sign up for their monitoring services on an ongoing basis.

Chairman Fleming asked staff to contact the law firm and clarify what they are offering to do for TSRS. He asked if the Board would have to take action for staff to enter into an agreement with the law firm on behalf of the TSRS Board.

David Deibel advised the Board could wait for staff to report back to the Board regarding the actual audit report the Board will get to ensure the reports are manageable before making a decision. The Board may decide they want the service but they may also want to look at other law firms.

Mr. Hermanson said a direction letter would have to be signed for BNY Melon so that they would share the necessary information. A letter had been provided by the law firm.

4. Board discussion of IAPC report and consideration of response to Mayor & Council

Michael Hermanson said there was a question as to whether the Board would like to respond to the IAPC report with further information over and above the response already provided by Silvia Amparano, the Finance Director. The response from Ms. Amparano challenged the IAPC's findings. He asked if there was any further action the Board would like to take.

Silvia Amparano suggested the Board not respond because there have been changes on the IAPC that may change their scope moving forward. A subcommittee was established to look at further options and it would be premature to take any action before the members of the subcommittee have been decided.

Mr. Hermanson advised staff has prepared materials to provide the IAPC with some education regarding open vs. closed funding. They have not specifically asked for those materials but staff is ready to provide it to them.

Catherine Langford asked if the education materials provided an explanation as to why the City would use a closed funded system if TSRS was terminated.

Mr. Hermanson answered he thought it would be good to add an explanation as to why TSRS would take that approach. In the event of a closed program, best practice indicates the plan's fiduciaries would recommend a more aggressive funding posture using an amortization period that matches the period with the average remaining service lives for vested members.

Ms. Amparano advised that she did not know how far the IAPC would go into researching the different alternatives to a defined benefit plan and she was reluctant to invest too many resources before receiving feedback from the subcommittee.

Mr. Hermanson said he thought it would be helpful to explain the difference between open and closed amortization approaches as well as incorporate the projected funding ratio over the long term of using those 2 approaches, and finally he would include the current TSRS funding policy because it was a derivative of something that is in between an open and closed approach, because the current policy incorporates a round up addition to the actuary's determined rate to put more money into the plan, which improves the funded ratio more quickly.

E. **Articles for Board Member Education / Discussion**

1. Trends in Social Security Claiming (Center for Retirement Research, May 2015)
2. Illinois Pension Reform Law Unconstitutional (Pensions & Investments, May 8, 2015)

F. **Call to Audience** – None heard.

G. **Future Agenda Items**

Michael Hermanson said he had noted the following items for future agendas:

- Adoption of the Investment Policy Statement
- Overview of the Board's Governance Policies
- Interview of Candidates to Fill the Vacant Board Seat
- Securities Litigation Oversight Agreement (if new information is received)

H. **Adjournment** – 10:48 AM

Approved:

Fleming 6/25/15 06-25-15

Robert Fleming — Date — Michael Hermanson — Date
Chairman of the Board — Plan Administrator